

**Supplemental Letter of Findings: 04-20200313P
Gross Retail Tax Fraud Penalty
For the Years 2014 through 2018**

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

The Department found that Indiana HVAC Company was not subject to the one hundred percent "fraud penalty" but was subject to the ten percent negligence penalty.

ISSUE

I. Gross Retail Tax - Fraud Penalty.

Authority: IC § 6-8.1-10-4; IC § 6-8.1-10-2.1; *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Indiana Dep't of State Revenue v. Rent-A- Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); [45 IAC 15-5-7](#).

Taxpayer argues that it is entitled to an abatement of the one-hundred percent fraud penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana HVAC company in the business of selling and installing HVAC equipment, water heaters, appliances, plumbing hardware and the like. Taxpayer was incorporated in 1997 as an S Corporation with Husband and Wife as the two sole shareholders. Taxpayer was administratively dissolved in 2013 and its Indiana state tax accounts were closed.

The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's tax returns and business records. According to the resulting audit report, Taxpayer continued to conduct its HVAC and plumbing business after it was administratively dissolved. In doing so, it conducted retail sales of tangible personal property, charged its customers Indiana sales tax, but failed to remit the collected tax to the state of Indiana.

During the course of the audit examination, Taxpayer filed its missing 2014 through 2018 sales tax returns and paid the tax charges. The audit report notes, "[A]s a result, there is zero tax due, and the Department will not be assessing any tax due for these filing periods." However, the Department assessed Taxpayer a one hundred percent "fraud" penalty explaining that "[Taxpayer] had a sales tax account, closed it, stopped filing sales tax returns but still collected sales tax." The penalty amount was issued in the form of "proposed assessments."

Taxpayer disagreed with the assessments and submitted a protest to that effect. In its protest submission, Taxpayer asked for a "[f]inal determination without a hearing." As a result, the Department issued Letter of Findings 04-20200313P denying Taxpayer's protest. Taxpayer petitioned for a rehearing, which was granted. The rehearing was held, and this Supplemental Letter of Findings results. Additional facts will be provided as necessary.

I. Gross Retail Tax - Fraud Penalty.

DISCUSSION

The issue is whether Taxpayer has provided the documentation and explanations necessary to establish that it is entitled to abatement of the fraud penalty.

As with any other assessment, the assessment of the penalty constitutes evidence that the Department's claim for

the unpaid tax is valid, and each taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); *Indiana Dep't of State Revenue v. Rent-A- Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Thus, a taxpayer is required to provide documentation explaining and supporting his or her challenge that the Department's position is wrong. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012).

A one-hundred percent penalty was assessed because of the substantial disparity between the amount of taxes Taxpayer received from its customers and the amount of taxes which were forwarded to the Department.

IC § 6-8.1-10-4 provides:

- (a) If a person fails to file a return or to make a full tax payment with that return with the fraudulent intent of evading the tax, the person is subject to a penalty.
- (b) The amount of the penalty imposed for a fraudulent failure described in subsection (a) is one hundred percent (100 [percent]) multiplied by:
 - (1) the full amount of the tax, if the person failed to file a return; or
 - (2) the amount of the tax that is not paid, if the person failed to pay the full amount of tax.
- (c) In addition to the civil penalty imposed under this section, a person who knowingly fails to file a return with the department or fails to pay the tax due under [IC 6-6-5](#), [IC 6-6-5.1](#), or [IC 6-6-5.5](#) commits a Class A misdemeanor.
- (d) The penalty imposed under this section is imposed in place of and not in addition to the penalty imposed under section 2.1 of this chapter.

There are five elements to fraud which must be present to prove the fraud. These elements are laid out in [45 IAC 15-5-7\(f\)\(3\)](#), which states:

A person who files a return which makes a false representation(s) with knowledge or reckless ignorance of the falsity will be deemed to have filed a fraudulent return. There are five elements to fraud.

(A) Misrepresentation of a material fact: A person must truthfully and correctly report all information required by the Indiana Code and the department's regulations. Any failure to correctly report such information is a misrepresentation of a material fact. Failure to file a return may be a misrepresentation.

(B) Scienter: This is a legal term meaning guilty knowledge or previous knowledge of a state of facts, such as evasion of tax, which it was a person's duty to guard against. A person must have actual knowledge of the responsibility of reporting the information under contention. However, the reckless making of statements without regard to their truth or falsity may serve as an imputation of scienter for purpose of proving fraud.

(C) Deception: Deception operates on the mind of the victim of the fraud. If a person's actions or failure to act causes the department to believe a given set of facts which are not true, the person has deceived the department.

(D) Reliance: Reliance also concerns the state of mind of the victim and is generally considered along with deception. If the person's actions, failure to act, or misrepresentations cause the department to rely on these acts to the detriment or injury of the department, the reliance requirement of fraud will be met.

(E) Injury: The fraud instituted upon the department must cause an injury. This can be satisfied simply by the fact that the misrepresentation(s) caused the department not to have collected the money which properly belongs to the state of Indiana.

In order to demonstrate fraud, the Department is required to prove all of the above elements are present. This must be shown by clear and convincing evidence.

Taxpayer argues its failure to remit sales tax was unintentional. Since its inception in 1997, Husband was responsible for the administration of the business, which included all returns, payroll, tax, and other types of "paperwork." Wife was responsible for the operation of the business including scheduling and answering the phone. Husband fell seriously ill and Wife was forced to take over both aspects of the business as well as take care of Husband. Wife was able to work through payroll and withholding tax but was unaware of other responsibilities such as maintaining Taxpayer's business status and filing sales tax returns. As such, Taxpayer

was administratively dissolved without Taxpayer's knowledge. During the audit Taxpayer agreed with the sales tax due and hired a representative to file amended sales tax returns. Taxpayer also paid sales tax plus interest found during the audit. Further, Taxpayer points out that prior to Husband's illness, Taxpayer had filed all its sales tax returns and paid all the sales tax due. Taxpayer has since engaged representation to file its returns in the future to ensure its future compliance.

The first element of fraud is misrepresentation of material fact. In its original Letter of Findings, the Department determined that the disparity between the amount of sales tax the Taxpayer collected from its customers and the amount of sales tax reported to the Department was proof that Taxpayer committed a misrepresentation of material fact. Presuming that Taxpayer conducted numerous transactions which included the collection of sales tax, the Department inferred that Taxpayer had actual knowledge of the repeated misrepresentations. At the very least, the Department determined that Taxpayer exhibited a reckless regard for the truth. Based on Taxpayer's presumed actual knowledge of the misrepresentations or reckless disregard, the Department determined that the second element of fraud, scienter, had been proven. Regarding the deception and reliance elements of fraud, the original Letter of Findings stated that the Department accepted and relied upon Taxpayer's representation that it chose to administratively dissolve, close its accounts, and thus was no longer collecting sales tax. The Department was injured by this reliance as it was unable to collect sales tax to which it was entitled.

The scienter element of fraud is very difficult to prove and is not inherently present merely because the other four elements are present. When a Taxpayer has collected a tax over a period of time without remitting that tax to the Department, the presence of fraud is certainly something the Department may explore during an audit. In the course of the rehearing, Taxpayer explained that Wife was running the business for the first time and was overwhelmed and inexperienced. Nothing in the audit report, notes, protest documents, or hearing prove that Taxpayer's actions rose to the level of scienter.

Because Taxpayer's actions did not rise to the level of scienter, the imposition of the fraud penalty was inappropriate and will be abated. However, Taxpayer may be subject to the negligence penalty under IC § 6-8.1-10-2.1. For the relevant period that statute states a person that:

(a) Except as provided in [IC 6-3-4-12\(k\)](#) and [IC 6-3-4-13\(l\)](#), a person that:

- (1) fails to file a return for any of the listed taxes;
- (2) fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment;
- (3) incurs, upon examination by the department, a deficiency that is due to negligence;
- (4) fails to timely remit any tax held in trust for the state; or
- (5) is required to make a payment by electronic funds transfer (as defined in [IC 4-8.1-2-7](#)) overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department;

is subject to penalty.

(b) Except as provided in subsection (g), the penalty described in subsection (a) is ten percent (10 percent) of:

- (1) the full amount of the tax due if the person failed to file the return;
- (2) the amount of tax not paid, if the person filed the return but failed to pay the full amount of the tax shown on the return;
- (3) the amount of the tax held in trust that is not timely remitted;
- (4) the amount of deficiency as finally determined by the department; or
- (5) the amount of tax due if a person failed to make payment by electronic funds transfer, overnight courier, or personal delivery by the due date.

Here Taxpayer failed to file sales tax returns or remit tax held in trust for the state. When viewed with Taxpayer's previous good filing record, the extenuating circumstances of Husband's serious illness, and the remedial actions taken by Taxpayer to rectify the failure to file returns, Taxpayer's actions were not fraudulent but were certainly negligent. Thus, Taxpayer is subject to the ten percent negligence penalty for the tax year at issue. During the audit Taxpayer paid the tax due but did not pay any penalties. The fraud penalty assessments will be abated, and negligence penalty assessments will be issued.

FINDING

Taxpayer's protest in relation to the fraud penalty is sustained, however Taxpayer is subject to the ten percent negligence penalty.

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